IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

MARK NEWBY,	§	**CIVIL ACTION NO. 01-CV-3624**
	§	**(Consolidated)**
Plaintiff,	§	
v.	§	
	§	
ENRON CORPORATION, et al.	§	
	§	
Defendants.	§	

OUTSIDE DIRECTORS' REPLY IN SUPPORT OF MOTION FOR PROTECTION FROM BANKRUPTCY RULE 2004 SUBPOENAS

The Creditors' Committee's Response to the Outside Directors' Motion for Protection admits that the Committee may not conduct Rule 2004 discovery from any person who is a party to or is affected by the lawsuit it filed against certain former officers and directors of Enron.[1] The law is clear on that point, and the Committee does not dispute it.[2] Instead, the Committee repeatedly argues that the Outside Directors are not affected by the Committee's pending lawsuit against certain former officers and directors of Enron. *See* Committee Response at 4, 6, 7-9. That is simply not

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[1] *See* Response of the Official Committee of Unsecured Creditors of Enron Corp., et al, to the Outside Directors Motion for Protection From Bankruptcy Rule 2004 Subpoenas ("Committee Response") at 7.

[2] *See Snyder v. Society Bank*, 191 B.R. 40 (S.D.Tex. 1994); *In re Szadkowski v. Sweetland*, 198 B.R. 140 (Bankr. D. Md. 1996); *In re the Bennett Funding Group*, 203 B.R. 24 (N.D.N.Y. 1996); *In re 2435 Plainfield Ave.*, 223 B.R. 440 (Bankr. D.N.J. 1998). All of these cases are cited by both the Outside Directors and the Creditors' Committee for the proposition that Rule 2004 discovery cannot be had from persons affected by pending litigation.

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true. It is plain from the face of the Creditors' Committee lawsuit[3] that the Outside Directors will be directly affected by that lawsuit and the discovery conducted in it. Because the Outside Directors will be so affected, the Outside Directors should be granted protection from the Creditors' Committee Subpoenas.

I. The Outside Directors Properly Seek Protection From This Court.

This Court should grant the Outside Directors' Motion For Protection for three reasons: (1) the Creditors' Committee subpoena – admittedly seeking discovery to the benefit of a litigant in *Newby* – was issued to the Outside Directors in direct contravention of this Court's Order that discovery in the *Newby* litigation is stayed; (2) the Creditors' Committee has filed litigation that is pending in this Court, that directly affects the Outside Directors, *requires* that the Outside Directors be afforded the minimum protections provided by the Federal Rules of Civil Procedures and prohibits the Committee from subjecting the Outside Directors to boundless discovery expeditions; and (3) under the Federal Rules, this is the proper Court from which subpoenas directed to certain Outside Directors must be served and challenged.

First, this Court has directed that discovery in the *Newby* litigation is stayed. *See* August 7, 2002 Order at 4. JPMorgan Chase, a litigant in the *Newby* and *Tittle* actions, admits that it "would expect to have access to the results of Rule 2004 discovery." Response of Defendant JPMorgan

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[3] *See Official Committee of Unsecured Creditors of Enron Corp. v. Andrew S. Fastow et al.*, No. H-02-3939 (S.D. Tex.) ("Committee's Petition"). As the Committee does not deny, (Committee Response at 6) the lawsuit has been "removed to this court." Moreover, concurrently with the filing of this motion, Defendants to that suit have filed Notice of Consolidation of that action under Judge Rosenthal's December 12, 2001 Order, in this Court.

Chase & Co. to the Outside Directors' Motion For Protection at 3 ("JPMorgan Response").[4] JPMorgan cannot be permitted to contravene this Court's Order that discovery is stayed simply because it "would be precluded from sharing it with anyone not on the Committee." JPMorgan Response at 3. Early access to the discovery sought by JPMorgan and its co-Committee members[5] is impermissible under this Court's August 7, 2002 Order.

Second, as demonstrated below, the Creditors' Committee has filed litigation fundamentally affecting the Outside Directors. The Creditors' Committee's lawsuit is pending in this Court. *See supra* note 3. Only this Court has the authority to direct discovery against affected parties such as the Outside Directors – and the Committee, having filed its suit, must play by the Federal Rules.

Finally, the Committee dismisses the Outside Directors' argument that the subpoenas served on John Duncan and John Mendelsohn, among others, were improper, noting that "...the Committee will reissue the subpoenas and thereby remedy any procedural defect..." Committee Response at 12, n.4. Properly issued, John Duncan and John Mendelsohn's subpoenas would have issued out of the Southern District of Texas. Fed. R. Civ. P. 45(b)(2). *See also In re Symington*, 209 B.R. 678, 688

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[4]JPMorgan Chase's attempts at distinguishing its role as a member of the Committee from its role as a litigant in *Newby* are circular at best. JPMorgan Chase argues that while it will have access to the discovery obtained from the Outside Directors, it "would receive that information solely in its role as a member of the Committee." JPMorgan Response at 3. Worded any way it pleases, the fact remains the same. It makes no difference whether JPMorgan Chase obtains early and sweeping discovery "as a member of the Committee," or in any other capacity. If JPMorgan Chase, along with its co-Committee members, are permitted to conduct discovery by the Committee's self-proclaimed "fishing expedition" (Committee Response at 5) they would have access to discovery in violation of this Court's Order that under the PSLRA "all discovery is stayed." *See* August 7, 2002 Order at 4.

[5]The Outside Directors have also learned that Silvercreek Management, Inc., also a member of the Creditors' Committee, has filed yet another Enron-related lawsuit in the Southern District of New York on November 7, 2002.

(D.Md. 1997) (Federal Rule of Civil Procedure 45 applies in Rule 2004 examinations). If the Creditors' Committee were to reissue the subpoenas as promised, there would be absolutely *no doubt* that they would be properly challenged in this Court. Fed. R. Civ. P. 45(c)(3). The Creditors' Committee would prefer to dictate the forum of relief through its own noncompliance with basic procedural rules. Respectfully, the Court may decide this issue without the need to wait for the Creditors' Committee to reissue the subpoenas (which may or may not actually happen).

II. The Committee May Not Conduct Rule 2004 Discovery On Issues Related To Its Lawsuit.

The Creditors' Committee entirely mis-characterizes the Outside Directors' argument, claiming that the Motion for Protection "rests on the erroneous contention that...the pending litigation prohibits the Committee from issuing Bankruptcy Rule 2004 examinations relating to matters affecting the Enron bankruptcy." Committee Response at 6. That is not the Outside Directors' position. Rather, the Outside Directors move for protection from the Creditors' Committee subpoenas because the law is clear that once litigation has been initiated, Rule 2004 discovery is not proper as to issues related to that litigation. Motion at 7-11; *In re 2435 Plainfield Ave., Inc.* 223 B.R. 440, 455 (Bankr. D.N.J. 1998) ("[W]here a party seeks to depose another party or a witness *on an issue which is the subject of a pending adversary proceeding*, the examination cannot be conducted pursuant to Rule 2004, but must be conducted pursuant to the Federal Rules of Civil Procedure.") (emphasis added).

As explained in the Motion for Protection, the subpoenas issued by the Creditors' Committee focus on Enron's use of its special purpose entities, which is the precise focus of the Committee's lawsuit. Committee Response at 4-6, 10-11. The Committee must conduct such discovery under

the Federal Rules.

III. In Addition, The "Pending Litigation" Limitation Applies To The Outside Directors as "Entities Affected By The Adversary Proceeding."

A. The Limitation Clearly Applies To Entities Affected By The Litigation As Well As Actual Parties.

Though they subsequently misapply it, the Creditors' Committee does not dispute the law which clearly extends the "pending litigation" limitation to discovery from entities simply *affected by* the litigation. The following comes directly from the Committee Response:

> The 'pending litigation' limitation, however, only applies to 'entities affected by the adversary proceeding.' *In re Buick*, 174 B.R. 299, 305 (Bankr. D. Colo. 1994)...(parties unaffected by pending litigation cannot avoid bankruptcy Rule 2004 discovery obligation).

Committee Response at 7. This law is undisputed; what we must address is the Creditors' Committee's misplaced logic arguing why the Outside Directors are *not* affected by the litigation.

B. Non-Parties May Be Affected By Pending Litigation.

The Creditors' Committee asserts in circular fashion that because the Outside Directors are not parties to the Committee's litigation, it therefore follows that the Outside Directors are not affected by that litigation. *See* Committee Response at 9 ("[T]he Committee *did not* name any of the Outside Directors as parties to an adversarial proceeding and *has not* asserted any claims against the Outside Directors. As such, the Outside Directors are not 'affected by any adversary proceeding' brought by the Committee."). Common sense and the law dictate that this conclusion is wrong.

"The majority of courts that have addressed this issue have prohibited a Rule 2004 examination of parties involved in *or affected by* an adversary proceeding while it is pending." *In re 2435 Plainfield Ave., Inc.* 223 B.R. 400, 455 (Bankr. D.N.J. 1998) (emphasis added). The rule

itself, as stated in *In re Plainfield Ave.*, thus acknowledges the sensible proposition that a person does not have to be "involved in" a lawsuit to be "affected by" it. Indeed, the court in *In re Plainfield Ave.* went on to state that "where a party seeks to depose another party *or a witness* on an issue which is the subject of a pending adversary proceeding, *the examination cannot be conduced pursuant to Rule 2004, but must be conducted pursuant to the Federal Rules of Civil Procedure.*" *In re 2435 Plainfield Ave., Inc.* 223 B.R. 440, 455 (Bankr. D.N.J. 1998)(emphasis added).

The *In re Plainfield Ave.* case makes clear that the Committee's sole argument – that somehow to be "affected by" litigation one must be an actual party – is simply incorrect. Rule 2004 discovery is improper as to a person affected by a pending lawsuit, regardless of whether that person is party to the lawsuit.

C. The Outside Directors Are Affected By The Committee's Lawsuit.

As explained in the Outside Directors' Motion for Protection, the Creditors' Committee lawsuit is based on the fact that the Outside Directors were deceived and mislead with respect to Enron's use of special purpose entities, and in particular the Chewco, LJM, Raptor and RADR entities and transactions. Motion at 12 (*citing* Creditors' Petition at ¶¶ 32, 36, 39, 40-42, 44, 57, 58, 66 and 67). The Committee alleges that the Outside Directors did not and could not have known about any improprieties involving these special purpose entities, and that the Outside Directors would have put an immediate stop to any wrongdoing had they known about it. *Id.*

As this Court is well aware, the *Newby* and *Tittle* complaints purport to assert securities fraud, ERISA and RICO claims against the Outside Directors based on conclusory allegations that the Outside Directors were somehow involved in the alleged wrongdoing associated with these special purpose entities. In other words, the *Newby* and *Tittle* plaintiffs hope to hold the Outside

Directors liable for the very alleged wrongdoing which the Creditors' Committee states was unknown or misrepresented to the Outside Directors. In light of these directly contrary allegations, it is common sense that the Outside Directors will certainly be affected by the Committee lawsuit and the discovery related to that lawsuit.

Unable to articulate a rationale for how its lawsuit could *not* affect the Outside Directors, the Committee simply repeats over and over that the Outside Directors are not parties to its lawsuit. *See* Committee Response at 2, 4, 6, 7. As explained above, however, that does not answer the question. The fact is that the Outside Directors will be affected by the Committee lawsuit and, accordingly, any discovery from the Outside Directors related to that lawsuit must be conducted pursuant to the Federal Rules of Civil Procedure.

D. The Committee May Conduct Discovery From The Outside Directors, But Only Pursuant To The Federal Rules Of Civil Procedure.

The Committee also argues that prohibiting it from conducting its Rule 2004 examinations of the Outside Directors "will foreclose discovery of matters relating to the Enron bankruptcy." Committee Response at 9. This is truly an exaggeration. The Outside Directors do not seek to prevent the Committee from ever conducting any discovery from them. Rather, the Outside Directors only ask that the Committee – as a litigant before this Court and comprised of members who are individual litigants in *Newby* and *Tittle* – be ordered to conduct its discovery under the Federal Rules of Civil Procedure. *See In re Blinder, Robinson & Co.*, 127 B.R. 267, 275 (Bankr. Colo. 1991) ("the Trustee is not prevented from conducting any discovery, he must simply comply with the Federal Rules.") As the Court is aware, the Directors have testified multiple times in Congress, an experience that has impressed upon them the need for this Court to manage discovery

under the Rules of Civil Procedure. The Outside Directors fully expect that their testimony – as well as that of other witnesses – will confirm what the Committee alleges: The Outside Directors had no knowledge of any wrongdoing in connection with any of Enron's special purpose entities, important information concerning these special purpose entities was withheld from the Outside Directors, and, if they had known of any wrongdoing, they would have immediately put a stop to it. *See* Committee's Petition at ¶ 6.

However, the Outside Directors are entitled to the protections afforded by the Federal Rules of Civil Procedure (and should not be subject to the "fishing expedition" of Rule 2004). As this Court is well aware, the *Newby* and *Tittle* plaintiffs have alleged claims against certain of the Outside Directors based on nothing more than conclusory statements that the Outside Directors must have known about wrongdoing at Enron simply by virtue of their position as Outside Directors. While the *Newby* and *Tittle* plaintiffs lack any facts to support an inference of wrongdoing on the part of any of the Outside Directors, the Outside Directors are nonetheless among the multitude of defendants in these massive class actions. Accordingly, it is critical that the Outside Directors be afforded the discovery protections of the Federal Rules, that discovery be coordinated (as this Court has ordered) and that the Outside Directors not be subjected to Rule 2004 discovery on matters directly relevant to all of the litigation pending in this Court, including the *Newby*, *Tittle* and Creditors' Committee's lawsuits.

In light of the pending litigation, subjecting the Outside Directors to Rule 2004 examinations on the issues germane to that litigation would be manifestly unjust. It is not proper for the Committee – or its members who are litigants before this Court – to obtain discovery from the Outside Directors under such one-sided procedures. Yet, JPMorgan Chase, a member of the

Creditors' Committee and a litigant in the *Newby* action, admits that "JPMorgan Chase would expect to have access to the results of Rule 2004 discovery." JPMorgan Response at 3. The Outside Directors stand ready, once the discovery stay has been lifted to participate in the discovery process – under the procedures and with the protections afforded by the Federal Rules. The rules are not different for JPMorgan and the Creditors' Committee.

Rule 2004 affords few of the protections of the Federal Rules, and thus could be easily abused. For example, under Rule 2004, "the witness has no right to be represented by counsel except at the discretion of the court; there is only a limited right to object to immaterial or improper questions; there is no general right to cross-examine witnesses; and no right to have issues defined beforehand." *In re Dinubilo*, 177 B.R. 932, 939-40 (E.D. Cal. 1993). JPMorgan, and the Creditors' Committee -- both of whom are litigants here -- cannot be permitted to end run this Court's discovery orders through the use of Rule 2004. To hold otherwise would set this litigation on the road to chaotic, duplicative and wasteful discovery.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I certify that a true and correct copy of this pleading was served on all counsel of record on the Service List on November 14, 2002 via posting to www.esl3624.com in compliance with the Court's Order Regarding Service of Papers and Notice of Hearings Via Independent Website. A true and correct copy of this pleading was also served on the following counsel for the Creditors' Committee via facsimile and certified mail return receipt requested.

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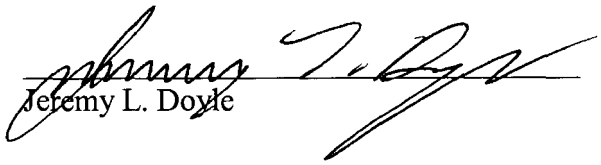

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